



Clarification of U.S. Withholding Adds a Layer of Complication for Literary Agents

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NEW U.S. REGULATIONS have increased the compliance burden related to the Literary Agency community. While these "New" regulations may at first seem like an administrative nightmare, they are not difficult to comply with once fully understood. However, failure to comply could lead to some substantial penalties.

By not understanding this new layer of compliance, Literary Agents could be opening themselves up to substantial financial exposure. Not filing forms 1042 and 1042-S could lead to a penalty of up to 10% of the total amount of the items that must be reported, with no maximum penalty. Not properly withholding could cause a Literary Agency to become liable for the amount of U.S. tax that should have been withheld!

What income is subject to withholding?

Foreign persons that receive income directly or indirectly are subject to a 30% U.S. withholding tax on such income, unless reduced by an income tax treaty. "New" withholding regulations under Internal Revenue Code ("IRC") Section 1441 enacted and modified over the last few years have been finalized and have taken effect as of January 1, 2001. These regulations are attempts to get the beneficial owners of the income to pay the appropriate U.S. taxes.

Who is responsible for the withholding?

These regulations clarify the rules regarding who is designated as the person responsible for the withholding and remitting of U.S. taxes attributable to the foreign person (known as the "withholding agent"). This designation is significant; as it is the withholding agent that the Internal Revenue Service ("IRS") will look to for recovery of the taxes if under withholding has occurred. In addition, these rules are administratively burdensome and create a significant responsibility to obtain the proper documentation for those who may be designated or found to be the withholding agent. As a general rule this withholding agent will be the "last" person in the U.S. who has control over an item of income before it is paid to the foreign person.

How do I know if the payee is foreign or domestic?

To ameliorate these regulations and their administrative requirements, the IRS has issued four new W-8 forms (the two most often used are listed below) which revise and replace the forms that have been used for decades (e.g., Form 1001, 4224, W-8, etc.) for foreign persons. U.S. persons must use Form W-9 to notify the withholding agent of their status as a U.S. taxpayer.

1. **Form W-8BEN**, Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding
2. **Form W-8IMY**, Certificate of Foreign Intermediary, Foreign Partnership, or Certain U.S. Branches for United States Tax Withholding

These W-8 Forms are then required to be obtained from the foreign person depending upon: (i) the type of income earned; (ii) whether an income tax treaty applies; or (iii) if the income is effectively connected with a U.S. trade or business. If (iii) applies, one of the W-8s must be obtained even though the foreign person is required to file a U.S. income tax return and is therefore not subject to U.S. withholding tax under IRC Section 1441. Generally, the executed W-8s are valid for a 3-year period. The foreign person will also need to obtain a tax identification number.

If no documentation is supplied to the withholding agent, they are required to withhold U.S. taxes at a 30% rate on that foreign person's share of income. If a U.S. taxpayer fails to provide a Form W-9 to the withholding agent, the withholding agent must assume the taxpayer is not a U.S. taxpayer, and withhold at a 30% rate. (The "mailbox rule" under the former regulations has been replaced effective January 01, 2001.)

In the situations where a U.S. agent is acting on behalf of a foreign agent or a chain of foreign agents, the foreign agent(s) must provide a Form W-8IMY along with the "ultimate owner" of the royalty's Form W-8BEN, to avoid or mitigate the U.S. withholding tax.

When and where do I file?

Once the withholding agent has the proper documentation and has determined what U.S. tax withholding is required, the next step is to deposit the withheld taxes within the prescribed time frame with an authorized bank and then file Form 1042 and 1042-S to report the withholding to the IRS and the foreign person, respectively. **The Forms 1042 and 1042-S are due by March 15th.**

Going forward?

These withholding regulations place the responsibility upon the withholding agent to obtain the appropriate documentation to reduce U.S. withholding tax on income below the 30% rate, but at a significant administrative burden. As this is an overview of a very complicated set of regulations, there are other aspects of these rules that may have an effect upon your particular circumstances. Therefore, it is important to consult your tax advisor to be sure your clients, agents (foreign & domestic) and others that may be affected are in compliance with these rules.

- Contributed by Keith Blitzer, CPA & Chris Feustal

